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Barroso's euro optimism questioned, as UK Prime Minister promises in/out EU referendum

- Back to IBA news analysis main page
- Have your say

By Scott Appleton

The start of 2013 may not have seen the same degree of fatalism surrounding the cohesion of the European Union (EU) and eurozone as January 2012, but the recent announcement by the EU President José Manuel Barroso that the existential crisis affecting the euro is over has raised eyebrows across Europe.

The prospect of a return to stability is universally hoped for– and the euro has increased in strength over recent months – but despite an apparent renewed appetite for sovereign bonds from some peripheral eurozone countries the economic outlook across the EU remains very difficult according to those on the ground.

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'Talking to colleagues across Europe any high level optimism in, for example, the bond markets, has a long way to go before it trickles down to the economy at large,' says Jonathan Wood, Head of International Arbitration at Reynolds Porter Chamberlain (RPC) in London, and an Advisory Board Member of the IBA's European Regional Forum. 'The outlook for most people remains very tough and will likely continue to be so for the coming years, despite what the politicians say.'

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Economic sickness

Talk even of economic stability is considered premature by some, while deep concerns remain over the impact of the austerity measures being demanded from countries as a condition of EU financial assistance – demands which are arguably making a bad situation worse.

'There is a sense in all this of political propaganda. It may be the case that Portugal is adhering to the demands of the Troika and public debt is starting to fall but people see through it. The positivity is completely artificial,' says Claudia Santos Cruz, partner with AVM Advogados in Lisbon and Senior Vice-Chair of the IBA's European Regional Forum.

Barroso's comments were delivered in his native Portugal, recipient of a €78bn EU bail-out in May 2011. Portugal has requested a further year's extension to the EU deadline to reduce its budget deficit, following similar concessions made to Greece and Ireland.

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Claudia Santos Cruz
Partner, AVM Advogados, Lisbon

'Portugal is living [through] a form of economic sickness. The economic reforms that are being pushed through are being done at a very significant social cost – 120,000 public sector redundancies were just announced and while tax levels continue to rise, tax revenues are actually falling,' adds Santos Cruz.

The Portuguese government's 2013 budget predicts a third year of recession. Attempts to raise taxes (current top rate 55 per cent) even further were referred to the country's Constitutional Court by the Portuguese President, Anibal Cavaco Silva. Plans to raise social security contributions from 11 to 18 per cent have already been rejected in the face of overwhelming public opposition. Barroso's optimism about the euro is also in stark contrast to German Chancellor Angel Merkel who, in her New Year address, outlined what she sees as another troubling year for the eurozone.

Institutional fear

That EU members need to bring public spending levels under control is not questioned but the root and branch reform required to avoid future debt disparities, ensure real fiscal integration and eurozone stability is not happening quickly enough, regardless of political perceptions, some say.

'People feel that the EU is now heading for a level of political integration that is far outside Britain's comfort zone. They see treaty after treaty changing the balance between member states and the EU'

David Cameron
UK Prime Minister

In part this is an inevitable product of the short-termism of politics, suggests Wood. 'Within the UK's coalition government we see a growing questioning of the country's position within the EU, while both Italy and Germany will undergo general elections this year, and there the results are far from certain. All of this is an impediment to the kind of root and branch change that is really required of major EU institutions.'

The stability of the eurozone and the potential for economic contagion is a major concern notably of the UK, as the country faces the possibility of an unprecedented triple-dip recession. In his speech today, UK Prime Minister David Cameron pledged to renegotiate the UK's arrangement with the EU, and then to offer an in-out referendum on the new settlement, should his Conservative Party win a majority in the 2015 general election.

Lawyers note that across the EU, continuing cuts to public services combined with rising tax demands and unemployment levels present real threats of social upheaval.

'The sense of disaster that previously surrounded the euro is perhaps less apparent, and in Spain at least there is the impression that things are better than they were six months ago. But I'm not sure if there was too much negativism back then or too much optimism now, it is true that measures are being taken, but is also true that most of those measures were there last year' says Miguel Lamo de Espinosa, London Managing Partner at Gómez-Acebo & Pombo.

'Citizens are sick of the stories of corruption, in particular at times when austerity is required from them'

Miguel Lamo de Espinosa
Managing Partner, Gómez-Acebo & Pombo, London

'On the positive side the Spanish government is acting, on the negative side there are doubts as to Spanish financial institutions really confronting what they have to do in respect of their balance sheets. Also I am concerned with the understandable growing lack of confidence, indeed frustration, with politicians and political institutions. Citizens are sick of the stories of corruption, in particular at times when austerity is required from them.'

So even if the acute financial challenges facing the eurozone may be subsiding, deadlock in terms of political decision-making and deepening national recessions are generating worrying levels of voter dis-satisfaction, threatening greater isolationism and nationalism. Despite Barroso's comments, predictions are that the eurozone will continue to contract into 2014.

'The ability of the eurozone to pull itself out of the current malaise is being held back by some of the very same remedies being imposed on countries' to bring their finances under control,' concludes Santos Cruz. 'On-the-ground, Portugal at least remains right in the thick of the financial crisis, and for most people across the EU there is undoubtedly a sense that things will likely get worse before they get better.'